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Message Text

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ACTION EB-08

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O 051505Z AUG 78
FM AMEMBASSY OTTAWA
TO SECSTATE WASHDC IMMEDIATE 8296
INFO AMEMBASSY PARIS
USMISSION GENEVA
ALL CANADIAN POSTS POUCH

C O N F I D E N T I A L SECTION 01 OF 03 OTTAWA 03902

E.O. 11652: GDS
TAGS: EINV, CA
SUBJECT: TALKS WITH GOC ON AUTO INVESTMENT

USOECD, MTN
DEPARTMENT PLEASE PASS NSC, TREASURY, AND DOC

1. SUMMARY: IN U.S. DELEGATION TALKS WITH GOC OFFICIALS AUGUST 4 AGREEMENT WAS REACHED THAT COMPETITIVE INVESTMENT INCENTIVES BY DIFFERENT LEVELS OF GOVERNMENT WAS UNDESIRABLE. FORD INVESTMENT DECISION WAS MENTIONED ONLY IN CONTEXT OF BROADER GENERAL PROBLEM. TWO SIDES AGREED TO REVIEW EXISTING STUDIES AND VIEWS ON NORTH AMERICAN AUTO INDUSTRY, TO STUDY EXISTING INVESTMENT INCENTIVE PROGRAMS BY VARIOUS LEVELS OF GOVERNMENT IN BOTH COUNTRIES, AND TO SET UP INFORMAL CONSULTATIVE PROCEDURE WHEREBY EACH COUNTRY WOULD BE EXPECTED TO INFORM THE OTHER ON MAJOR INVESTMENT INCENTIVE DECISIONS WHICH MIGHT AFFECT THE OTHER. CONFIDENTIAL

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CANADIANS INDICATED CONSULTATIONS WOULD NOT PRECLUDE GOC FROM OFFERING INCENTIVES IF NECESSARY. THERE WAS AGREEMENT THAT TWO SIDES WOULD MEET AGAIN IN SEPTEMBER TO REVIEW PROGRESS. BOTH SIDES RECOGNIZED THAT WHILE NATIONAL INTERESTS OFTEN DIVERGE, IT WAS IN THE INTEREST OF BOTH TO AVOID ACTIONS WHICH COULD LEAD TO BREAKDOWN OF AUTO PACT WHICH HAS BROUGHT SUBSTANTIAL

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BENEFITS TO BOTH SIDES. END SUMMARY.

2. U.S. DELEGATION LED BY ASSISTANT SECRETARY OF STATE KATZ, TREASURY ASSISTANT SECRETARY BERGSTEN, AND COMMERCE ACTING ASSIST. SEC. ABBUHL MET AUG 4 WITH GOC DELEGATION LED BY IT&C ADM LATIMER AND EXTAFF ASST.UNDER SECRETARY MCPHAIL. KATZ SAID WE DID NOT NEED TO FOCUS ON FORD DECISION TO LOCATE PLANT IN ONTARIO BUT TO DETERMINE THE DIRECTION GOVERNMENTS WERE GOING BY COMPETING FOR INVESTMENT IN AUTOS AND OTHER SECTORS. FEDERAL INCENTIVES OFFERED BY GOC RISKS OTHER MEASURES IN REACTION TO IMPROVE OUR COMPETITIVE POSITION.

3. BERGSTEN SAID WE VIEW THE ISSUE OF INCENTIVES MULTI-LATERALLY AS PART OF EFFORT IN THE MTN AND ELSEWHERE TO LIMIT INVESTMENT INCENTIVES AND SUBSIDIES ON A GLOBAL BASIS AND DEVELOP A SUBSIDIES/COUNTERVAILING CODE. BILATERALLY, THE GOC FEDERAL INCENTIVES RAISE QUESTIONS OF EMULATION, INCLUDING PRESSURES ON U.S. GOVERNMENT TO OFFER SIMILAR ASSISTANCE TO AUTO COMPANIES. WE ARE RESISTING THESE PRESSURES, BUT THEY ARE CURRENTLY INTENSE. CANADIAN ACTION ALSO RAISES QUESTION OF REACTION UNDER U.S. LAW AND IN ACCORDANCE WITH UNDERTAKINGS IN THE U.S.-CANADIAN AUTO PACT, THE OECD DECLARATION ON INCENTIVES AND CONFIDENTIAL

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DISINCENTIVES, AND OTHER INTERNATIONAL AGREEMENTS. WE HOPE TO AVOID FURTHER ACTION OF THIS TYPE AND PUT IN PLACE SOME DAMAGE CONTROL PROCEDURE TO NOTIFY EACH OTHER OF PROBLEMS IN ADVANCE. BERGSTEN NOTED THAT REVENUE LEVELS IN OHIO AND ONTARIO ARE COMPARABLE, SUGGESTING NO NEED FOR GOC INVOLVEMENT IN FORD CASE. WHILE WE ARE NOT HAPPY WITH INCENTIVES OFFERED BY U.S. STATES AND PLAN TO HAVE TALKS BETWEEN DIFFERENT LEVELS OF GOVERNMENT IN THE U.S., HE URGED GOC ALSO TO ADDRESS THIS PROBLEM WITH PROVINCIAL GOVERNMENTS.

4. LATIMER SAID THAT GOC DECISION TO OFFER FORD INCENTIVES SHOULD NOT BE VIEWED AS A GENERAL PATTERN BUT WAS AD HOC. GOC IS CONCERNED IT DOES NOT HAVE SUFFICIENT INFORMATION ON OPERATION OF NORTH AMERICAN AUTO SECTOR UPON WHICH TO SATISFACTORILY BASE DECISIONS. SOME REPORTS HAVE BEEN PREPARED SUCH AS THE ARTHUR REPORT AND SECTOR PROFILES AND THE STUDY NOW UNDERWAY BEING CONDUCTED BY SIMON REISMAN. BUT HE SAID BETTER INFORMATION AND A SHARING OF PER-CEPTIONS OF THE SITUATION IN THE AUTO INDUSTRY BY

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BOTH CANADA AND THE U.S. WAS NEEDED IN ORDER TO
BEST DETERMINE HOW TO PROCEED.

5. LATIMER ALSO SAID THERE WAS A QUESTION TO TIMING.
GOC WAS AFRAID IMPORTANT INVESTMENT DECISIONS WOULD
BE TAKEN IN THE NEAR FUTURE AFFECTING THE NORTH
AMERICAN AUTO SECTOR FOR THE NEXT DECADE; GOC FELT IT
HAD NO CHOICE BUT TO ACT IMMEDIATELY TO KEEP AN
ACCEPTABLE SHARE OF NEW INVESTMENTS. HE ACKNOWLEDGED
THAT OTHER INVESTMENT INCENTIVE DECISIONS WERE
PENDING. GENERAL MOTORS HAS BEEN OFFERED A FEDERAL
GRANT BY THE DEPARTMENT OF REGIONAL ECONOMIC EXPANSION
(DREE) AND BY THE PROVINCE OF QUEBEC. CHRYSLER

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HAD INDICATED IT MAY BE MAKING AN INVESTMENT DECISION
SOME TIME IN THE FUTURE BUT HAS MADE NO SPECIFIC
REQUEST AND HAS BEEN GIVEN NO SPECIFIC OFFER.

6. KATZ SAID WE HOPE THERE CAN BE SOME AGREEMENT
IN SHORT RUN TO CONSULT ABOUT PENDING INVESTMENT
DECISIONS WHICH AFFECT THE OTHER COUNTRY. HE SAID
THERE IS NO BASIS IN THE AUTO AGREEMENT FOR AN
OBJECTIVE OF TRADE BALANCED AT ANY PARTICULAR LEVEL.
IT HAS ALWAYS BEEN REALIZED THAT TRADE BALANCES WOULD
EBB AND FLOW IN KEEPING WITH LEVELS OF ECONOMIC
ACTIVITY IN THE TWO COUNTRIES AND THAT AUTO PACT

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VALUE TO BOTH COUNTRIES WAS MUCH BROADER BASED THAN
TRADE BALANCE.

7. LATIMER AGREED THERE WAS NOTHING MAGICAL
ABOUT TRADE BALANCE IN A SUB-SECTOR SUCH AS AUTO
AUTO PARTS. WHILE THERE IS CONSIDERABLE INDUSTRY
AND POLITICAL PRESSURE FOR AUTO PARTS BALANCE, HE
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SAID GOC WOULD RESIST PERCEPTION THAT AUTO PARTS
TRADE SHOULD BE BALANCED. RUBINOFF (ASSISTANT DEPUTY
MINISTER OF FINANCE) SAID THAT WHILE BALANCING
SECTORS DOES NOT MAKE SENSE, GOC FINDS IT IS FACING
LIMITS TO EFFECTIVE MACRO-ECONOMIC POLICIES. THESE
LIMITATIONS LEAD TO MICRO-ECONOMIC POLICY ACTION
BASED ON SECTORS SUCH AS AUTOS.

8. BERGSTEN AGREED THAT ATTENTION TO SECTORS WAS
SOMETIMES NECESSARY BUT THAT FEDERAL INVESTMENT
INCENTIVES REPRESENTED A QUALITATIVE MAJOR CHANGE
BECAUSE OF THE LARGER FINANCIAL RESOURCES INVOLVED
AND THE DANGER OF EMULATION.

9. LATIMER SAID THAT THE DREE OFFER TO GM WAS
FUNDAMENTALLY DIFFERENT THAN THE INCENTIVE OFFERED FORD,
AS DREE IS PART OF GOC'S REGIONAL ECONOMIC POLICY
PROGRAM DESIGNED TO INFLUENCE LOCATIONS OF INVESTMENT
WITHIN CANADA RATHER THAN WHETHER OR NOT INVESTMENT
TAKES PLACE IN CANADA PER SE. IN RESPONSE TO A
QUESTION, LATIMER ACKNOWLEDGED THAT GM HAD NOT
MENTIONED INVESTING IN A NON-DREE AREA OF CANADA NOR
HAD FORD SHOWN ANY INTEREST IN INVESTING IN A DREE
INCENTIVE AREA. HE DID NOT DISAGREE WITH COMMENT
THAT FORD IN EFFECT HAD RECEIVED A DREE INCENTIVE
FOR NOT INVESTING IN A DREE AREA. KATZ COMMENTED
THAT WHETHER OR NOT THERE IS BUREAUCRATIC OR LEGAL
DISTINCTION BETWEEN FEDERAL SUBSIDY TO FORD AND DREE
GRANT TO GM, THEY WOULD BE PERCEIVED IN U.S.
AS IN FACT PART OF A PATTERN OF ACCELERATING GOC FEDERAL
INVESTMENT INCENTIVES.

10. LATIMER SAID AUTO PACT CONTAINS IRRECONCILABLE
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OBJECTIVES OF (A) ENABLING INDUSTRIES OF BOTH COUNTRIES
TO PARTICIPATE ON A FAIR AND EQUITABLE BASIS IN THE

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EXPANDING TOTAL MARKET AND (B) DEVELOPING CONDITIONS
IN WHICH MARKET FORCES MAY OPERATE EFFECTIVELY TO
ATTAIN THE MOST ECONOMIC PATTERN OF INVESTMENT,
PRODUCTION AND TRADE. KATZ SAID HE DID NOT AGREE
OBJECTIVES WERE IRRECONCILABLE. WHILE THERE MAY BE
SOME DIFFERENT NATIONAL INTERESTS, FUNDAMENTAL
OBJECTIVES ARE THE SAME. IF DIFFERENT INTERESTS
ARE PRESSED TOO HARD, DIFFERENCES MAY BECOME
IRRECONCILABLE, LEADING TO COLLAPSE OF THE AGREEMENT.
HE SAID HE WAS NOT SUGGESTING THAT FEDERAL SUBSIDIES
TO FORD AND GM WILL LEAD THE U.S. TO TERMINATE
THE AGREEMENT, BUT THEY COULD BE SETTING IN MOTION
A CHAIN OF EVENTS WHICH COULD LEAD TO VERY UNDESIRABLE
SET OF CIRCUMSTANCES.

11. LATIMER AGREED OBJECTIVES WERE NOT IRRECONCILABLE,
BUT ATTEMPT WAS NEEDED TO BRIDGE PERCEPTION OF
STRONG DIFFERENCES ON BOTH SIDES. GOC BELIEVES
INVESTMENT PATTERN OVER THE NEXT TWO OR THREE YEARS
WILL BE CRITICAL TO THE NORTH AMERICAN AUTO INDUSTRY
FOR YEARS TO COME. HE SAID THAT EVEN IF COMPETITION
FOR INVESTMENT INCENTIVES BY U.S. STATES WAS ELIMINATED,
GOC MIGHT WELL STILL BELIEVE IT NECESSARY TO TAKE
ACTIONS AFFECTING INVESTMENT DECISIONS.

12. LATIMER PROPOSED THREE AREAS FOR FOLLOW-UP
ACTIVITIES. FIRST, EXAMINE THE OPERATION OF THE
NORTH AMERICAN AUTO INDUSTRY TO IMPROVE UNDERSTANDING.
HE SAID A SUB-GROUP COULD BE ESTABLISHED AND MAKE A
REPORT. SECOND, CARRY OUT STUDIES ON EXISTING
INVESTMENT ASSISTANCE PROGRAMS IN BOTH THE U.S. AND
CANADA IN ORDER TO GET A BETTER MEASURE OF THE
PROBLEM. GOC WOULD TAKE INITIATIVE TO SET UP

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MEETINGS OF BOTH WORKING GROUPS. THIRD, AGREE ON A CONSULTATIVE PROCESS, BUT TO LEAVE RATHER IMPRECISE WHAT KIND OF CONSULTATION WOULD TAKE PLACE.

13. BERGSTEN SAID WE WOULD LIKE TO MAKE EXPLICIT THAT IF INVESTMENT INTENTIONS COME TO THE ATTENTION OF EITHER SIDE WHICH ARE LIKELY TO AFFECT THE OTHER, THERE SHOULD BE SOME OBLIGATION FOR EACH TO INFORM THE OTHER. KATZ SAID THAT TERMS OF REFERENCE FOR CONSULTATION MIGHT BE IMPRECISE, BUT THEY SHOULD BE AS BROAD AS POSSIBLE, SUCH THAT WE WOULD CONSULT WHEN ANYTHING THAT CAME UP WHICH MIGHT RAISE A QUESTION TO THE OTHER. LATIMER AGREED THAT DREE MIGHT BE REQUESTED TO REVIEW ITS OFFERS IN THIS LIGHT. IT WAS AGREED THAT THE TWO SIDES WOULD AIM TO MEET AGAIN IN SEPTEMBER.

14. IN DISCUSSING THE DUTY REMISSIONS PROGRAM FOR VOLKSWAGEN, LATIMER DEFENDED THE DECISION SAYING
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CONSULTATIONS WITH THE U.S. HAD TAKEN PLACE. GOC UNDERSTOOD THE U.S. ADMINISTRATION WOULD NOT TAKE THE INITIATIVE IN INSTIGATING AN INVESTIGATION OF DAMAGE UPON WHICH TO BASE COUNTERVAILING DUTY ACTION. KATZ AND BERGSTEN SAID THEY KNEW OF NO SUCH UNDER-TAKING BY THE USG. DUTY REMISSION APPLIED ACROSS-THE-BOARD WITHOUT DISTINCTION TO ORIGIN OF PARTS REPRESENTS A QUANTITIVE INCREASE IN INCENTIVES.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: AUTOMOTIVE INDUSTRY, INVESTMENTS
Control Number: n/a
Copy: SINGLE
Draft Date: 05 aug 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978OTTAWA03902
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780321-0968
Format: TEL
From: OTTAWA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780894/aaaadasz.tel
Line Count: 320
Litigation Code IDs:
Litigation Codes:
Litigation History:
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Office: ACTION EB
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 08 jul 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1825815
Secure: OPEN
Status: NATIVE
Subject: TALKS WITH GOC ON AUTO INVESTMENT USOECD, MTN DEPARTMENT PLEASE PASS NSC, TREASURY, AND DOC
TAGS: EINV, ELTN, CA
To: STATE
Type: TE
vdkvgwkey: odbc://SAS/SAS.dbo.SAS_Docs/d57b1d68-c288-dd11-92da-001cc4696bcc
Review Markings:
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